

**BEFORE THE**  
**KENTUCKY PUBLIC SERVICE COMMISSION**

**In the Matter of:**

<b>APPLICATION OF LOUISVILLE GAS AND</b>	<b>)</b>	
<b>ELECTRIC COMPANY FOR APPROVAL OF</b>	<b>)</b>	<b>CASE No. 98-426</b>
<b>AN ALTERNATIVE METHOD OF REGULATION</b>	<b>)</b>	
<b>OF ITS RATES AND SERVICE</b>	<b>)</b>	

**TESTIMONY OF**  
**VICTOR A. STAFFIERI**  
**CHIEF FINANCIAL OFFICER**  
**LG&E ENERGY CORP.**

1     **Q.    Please state your name and business address.**

2     A.    My name is Victor A. Staffieri. My business address is 220  
3           West Main Street, Louisville, Kentucky 40202.

4     **Q.    What is your position?**

5     A.    I am Chief Financial Officer of LG&E Energy Corp. ("LG&E  
6           Energy") and its subsidiaries, Louisville Gas and Electric  
7           Company ("LG&E") and Kentucky Utilities Company ("KU")  
8           (jointly referred to as "the Companies").

9     **Q.    Please describe your education, background and employment**  
10          **experience.**

11    A.    I joined LG&E in March 1992 as Senior Vice President, General  
12           Counsel and Corporate Secretary. Since then, I have served in  
13           a number of positions. A description of my civic activities,  
14           employment experience and educational background is attached  
15           to this testimony as Appendix A.

16    **Q.    Please describe LG&E and KU.**

17    A.    LG&E provides retail electric service to approximately 356,000  
18           customers and retail gas service to approximately 284,000  
19           customers in 17 counties in Kentucky.

20           KU provides electric service to approximately 470,000  
21           customers in 77 counties in Kentucky and five counties in  
22           southwestern Virginia.

23           Both are utilities regulated by this Commission and, by  
24           reason of the May 4, 1998, merger of KU Energy Corporation

1 ("KU Energy") with LG&E Energy, are wholly-owned subsidiaries  
2 of LG&E Energy.

3 LG&E Energy is a holding company that is exempt from  
4 registration under the Public Utility Holding Company Act of  
5 1935 and is not a utility.

6 **Q. Please provide the Commission with a status update on the two**  
7 **utilities since the consummation of the merger.**

8 A. Following the approval of the merger by this Commission and  
9 the Companies' shareholders, we began to develop and implement  
10 an integration plan with input from and final decisions by the  
11 two Companies. Representatives of each functional area from  
12 both Companies held regular meetings to identify redundancies  
13 that could be eliminated, to consider best practices for  
14 implementation, and to develop a work plan for accomplishing  
15 a smooth transition when the merger was consummated. We made  
16 great strides during the first quarter of 1998 in developing  
17 the transition plan.

18 When the merger was consummated on May 4, 1998, we were  
19 ready to begin integrated operations. For example, the  
20 electric generation systems of both LG&E and KU have been  
21 jointly dispatched since May 4, 1998, pursuant to LG&E Energy  
22 FERC Rate Schedule No. 1. We also began operating the  
23 transmission assets of LG&E and KU as a single transmission  
24 system on May 4, 1998, pursuant to LG&E Energy FERC Rate

1 Schedule No. 2. At the same time, many of our administrative  
2 and general functions, such as accounting, environmental  
3 affairs, fuel procurement, regulatory affairs, and marketing  
4 and sales, began operating as single entities serving both  
5 utilities. More hard work is ahead of us, but we are  
6 confident that our teamwork will allow us to turn challenges  
7 and problems into opportunities.

8 We are now beginning the difficult work of achieving the  
9 cost savings identified during the discussions that led to the  
10 merger agreement. Customers, however, already are receiving  
11 the benefits from the merger. Customers of LG&E and KU began  
12 receiving lower bills on July 1, 1998, through the merger  
13 surcredits and through the fuel adjustment factors. The  
14 merger surcredit is the rate mechanism that is being used for  
15 distributing to customers their share of the estimated non-  
16 fuel savings we are working to achieve during the next five  
17 years as a result of the merger. The lower fuel costs created  
18 by the joint dispatch of the LG&E and KU generation units are  
19 distributed to customers through the fuel adjustment clause  
20 factors. Our commitment to cap base rates also has taken  
21 effect, ensuring that customers will get the benefits of the  
22 merger surcredit and rate stability over five years. Although  
23 our current and future tasks are not easy, we remain dedicated  
24 to their successful accomplishment.

1     **Q.   What is the purpose of this application?**

2     A.   In its September 12, 1997, Order in Case No. 97-300, the  
3           Commission approved the acquisition of control by LG&E Energy  
4           of LG&E and KU, upon the merger of KU Energy into LG&E Energy.  
5           That Order, in a section entitled "Future Regulation," states  
6           in part:

7                     [P]roposals to deregulate the electric industry and  
8                     the emergence of competition in both the wholesale  
9                     and retail markets will create a new environment .  
10                    . . . [T]he Commission recognizes that as we enter  
11                    this new era, traditional rate-making techniques  
12                    may not ensure that ratepayers and stockholders  
13                    share in the benefits of competition in the same  
14                    balance as in the current environment.

15  
16                    Therefore, LG&E and KU shall file . . . detailed  
17                    plans to address any future rate regulation . . . .  
18                    [I]f either utility elects non-traditional  
19                    regulation, the reasons for this choice should be  
20                    disclosed, along with the details of a proposal and  
21                    how it will achieve the Commission's goals of  
22                    providing incentives to utilities and a sharing of  
23                    resulting benefits with ratepayers.

24  
25           The purpose of this application is to advise the Commission of  
26           the decision of LG&E and KU to elect non-traditional  
27           regulation, demonstrate the reasons for this choice, present  
28           in detail the proposed alternative method of regulation and  
29           how it will achieve the Commission's goals, and request  
30           approval by the Commission of the alternative method of  
31           regulation. The application presents a detailed and  
32           comprehensive proposal addressing future regulation.

1     **Q.   What is the purpose of your testimony?**

2     A.   My testimony provides an overview of the testimony of our  
3         other witnesses, advises the Commission of LG&E's and KU's  
4         decision to elect non-traditional regulation and briefly  
5         explains the basis of the decision.

6     **Q.   Please identify the other witnesses and the subjects they will**  
7         **cover.**

8     A.   We are presenting the testimony of five other witnesses in  
9         this case in support of our application.

10             Dr. Mark Lowry with Christensen Associates explains the  
11             theory and current application of alternative regulation,  
12             presents an economic analysis that demonstrates the historical  
13             superior performance by LG&E and KU, and supports the fuel  
14             index used in the fuel cost recovery component of the  
15             alternative method.

16             Donald F. Santa, Jr., Senior Vice President, Deputy  
17             General Counsel for LG&E Energy Corp. explains why  
18             implementing non-traditional regulation is now appropriate and  
19             why we believe that this will achieve the Commission's goals  
20             of providing incentives to the utilities and a sharing of  
21             benefits between customers and shareholders.

22             Ronald L. Willhite, Vice President of Regulatory Affairs  
23             for Louisville Gas and Electric Company and Kentucky Utilities  
24             Company, addresses the regulatory issues involved in the

1 alternative method of regulation proposed in our application,  
2 describes the details of the proposed Electric Rate Schedule  
3 Electric Performance-Based Rate ("EPBR") tariff, discusses how  
4 the EPBR tariff should be implemented, and presents our  
5 request for greater flexibility in our tariff filings in order  
6 to market tailored services to meet particularized customer  
7 needs.

8 Dr. Larry Kaufmann, a senior economist with Christensen  
9 Associates, describes in detail the quality-of-service  
10 component of the alternative method of regulation.

11 Stephen R. Wood, President of Louisville Gas and Electric  
12 Company, reviews LG&E's high standards for safety, system  
13 reliability, and customer satisfaction and discusses how the  
14 proposed alternative method of regulation will continue to  
15 promote and strengthen LG&E's performance in achieving these  
16 goals.

17 **Q. Please advise the Commission of the decision of LG&E and KU on**  
18 **their method of regulation in the future.**

19 A. LG&E and KU have elected a non-traditional or an alternative  
20 method of regulation.

21 **Q. Why have LG&E and KU elected a non-traditional or an**  
22 **alternative method of regulation?**

23 A. Our proposal meets the long-term needs of our customers for  
24 low rates and excellent service. Our proposal also meets the

1 Commission's goals "of providing incentives to utilities and  
2 a sharing of resulting benefits with ratepayers" as stated in  
3 the final Order granting approval to merge in Case No. 97-300.  
4 Our proposal will allow LG&E and KU to maintain the balance of  
5 regulatory goals identified in the same Order of "low rates  
6 and reliable service to ratepayers, and healthy returns for  
7 stockholders."

8 The alternative method of regulation that we are  
9 proposing represents a sound, long-term approach for  
10 regulating electric utilities in Kentucky whether or not the  
11 Commonwealth chooses to implement retail customer choice for  
12 electricity. An alternative method of regulation, such as  
13 performance-based regulation, provides incentives and sharing  
14 mechanisms that more appropriately simulate the competitive  
15 forces currently affecting the electric utility industry, as  
16 well as the changes to come. It can encourage these utilities  
17 to maintain low rates, provide high quality of service and be  
18 superior performers relative to other utilities. It can  
19 provide the flexibility needed for being more responsive to  
20 customers' demands. Although alternative ratemaking methods  
21 will impose more risk on the Companies, this additional risk  
22 is acceptable because it correctly aligns the interests of all  
23 stakeholders.



1           Moreover, changing market circumstances and customer  
2 demand require a change in the method of regulation. In our  
3 view, additional managerial, operational and marketing  
4 flexibility will become necessary in the near future to  
5 maintain the enviable competitive position that utilities in  
6 Kentucky have achieved and to respond effectively to new  
7 competitive pressures.

8           Thus, we believe that, during this transition to a more  
9 competitive market for electric power, it is appropriate to  
10 consider alternatives to the current regulatory framework.  
11 Mr. Santa's testimony discusses in greater detail the  
12 inevitability of electric power industry restructuring and  
13 explains that, overall, public policy at both the state and  
14 federal level supports the move toward competitive electric  
15 power markets at both wholesale and retail. These imminent  
16 changes in the electric power industry create an additional  
17 need for alternative methods of regulation that align the  
18 interests of the investors, customers and regulators during  
19 the transition period.

20           In conclusion, we believe that sound regulation and  
21 efficient management have served the customers well and  
22 allowed us to achieve excellent results. However, we believe  
23 our alternative ratemaking proposal provides an enhanced form  
24 of regulation that enables us to maintain and improve on these

1 results that we have all worked so hard to achieve. Finally,  
2 our proposal allows us to meet the challenges presented by the  
3 changes in the industry.

4 **Q. Please give a general description of the proposed alternative**  
5 **method of regulation.**

6 A. The alternative method of regulation uses the performance of  
7 LG&E and KU as the criteria for fair, just and reasonable  
8 rates rather than the traditional methods of cost-of-service  
9 and rate-of-return. In general, the proposal provides  
10 incentives for our management to improve its already-excellent  
11 performance in fuel procurement, shares the benefits of  
12 effective operation of the generation system, and protects  
13 the current high-level of quality service from any decline  
14 through a procedure that either penalizes or rewards us based  
15 upon objective measurements of service quality. The proposal  
16 also allows us greater flexibility to work with customers to  
17 meet their increasing and varied demands for high quality  
18 service. The details and implementation of the proposal and  
19 how it meets the Commission's "goals of providing incentives  
20 to utilities and a sharing of resulting benefits with  
21 ratepayers" are discussed in Mr. Willhite's testimony.

22 **Q. Is this LG&E's first proposal for an alternative method of**  
23 **regulation?**

1 A. No. The Commission recommended that LG&E investigate the use  
2 of performance-based regulation as a means of improving  
3 quality-of-service, reducing costs and improving returns in  
4 the 1995 Comprehensive Management Audit of LG&E. A copy of  
5 Rec. III-R-7 is attached to my testimony as Exhibit VAS-1.  
6 The Commission approved an alternative method of regulation  
7 for LG&E's gas supply clause by incorporating an experimental  
8 performance-based ratemaking mechanism in Case No. 97-171.

9 In addition, forms of alternative ratemaking rapidly are  
10 becoming common in other jurisdictions across the country.  
11 The application of alternative ratemaking across the nation is  
12 explained by Dr. Lowry in his testimony.

13 **Q. Are the issues of how to restructure the electric industry**  
14 **relevant to this proceeding?**

15 A. No. The General Assembly in H.J.R. 95 established an  
16 Electricity Restructuring Task Force to study this matter  
17 during the 1998-2000 legislative interim and issue a report by  
18 November 15, 1999. The report will be submitted to the  
19 Legislative Research Commission and the Governor to facilitate  
20 the discussion on and consideration of the need for state  
21 legislation to implement restructuring the electric industry  
22 in Kentucky. There also is a separate Task Force on Utility  
23 Tax Policy established by H.J.R. 89 that is charged with  
24 investigating and reporting on the impact that restructuring

1 utility industries will have on the Commonwealth's tax system  
2 and budget. These matters are more appropriately suited for  
3 the forums designated by the General Assembly and are too  
4 complicated and involve too many interests to be considered  
5 thoroughly in this proceeding.

6 **Q. What Commission action do you recommend?**

7 A. I recommend the Commission grant the relief we have requested  
8 in our application.

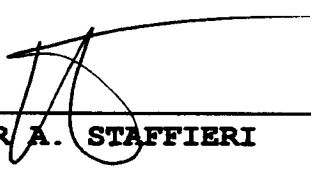
9 **Q. Does this conclude your testimony?**

10 A. Yes, it does.

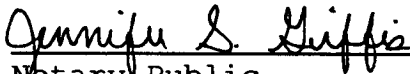
**VERIFICATION**

**STATE OF KENTUCKY     )**  
                                 **) SS:**  
**COUNTY OF JEFFERSON )**

The undersigned, **VICTOR A. STAFFIERI**, being duly sworn, deposes and says he is Chief Financial Officer of LG&E Energy Corp. and its subsidiaries, Louisville Gas and Electric Company and Kentucky Utilities Company, that he has personal knowledge of the matters set forth in the foregoing testimony, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

  
\_\_\_\_\_  
**VICTOR A. STAFFIERI**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 8<sup>th</sup> day of October, 1998.

\_\_\_\_\_(SEAL)  
Notary Public

**My Commission Expires:**

Notary Public, State at Large, KY  
My commission expires Aug. 20, 2001

**APPENDIX A**  
**VICTOR A. STAFFIERI**

Chief Financial Officer  
LG&E Energy Corp.  
Louisville Gas and Electric Company  
Kentucky Utilities Company  
220 West Main Street  
Louisville, KY 40202

**CIVIC ACTIVITIES:**

**Boards:**

Bellarmine College - Board of Trustees - 1995-1999  
    Executive Committee - 1997-1998  
    Finance Committee - 1995-1997  
    Strategic Planning Committee  
Jefferson County/Louisville Area Chamber of Commerce  
    Family Business Partnership - Co-Chair 1996-1997  
Kentucky Country Day - Board of Directors - 1996-1999  
Louisville Area Chamber of Commerce,  
    Board of Directors 1994-1997  
Metro United Way - Board of Directors - 1998-2001

**Other:**

Louisville Area Chamber of Commerce - Chair - 1997  
Louisville Area Chamber of Commerce - African-American  
    Affairs Committee - 1996-1997  
Louisville Area Chamber of Commerce, Vice Chairman  
    Finance and Administration Steering Committee - 1995  
The National Conference - Dinner Chair 1997  
Chairman of the Coordination Council for Economic Development  
    Activities -- Regional Economic Development Strategy -  
    1997  
Metro United Way - Cabinet Member - 1995 Campaign  
Boy Scouts of America - 1996 Annual Explorer Campaign

**EDUCATION:**

Fordham University School of Law, J.D. -- 1980  
Yale University, B.A. -- 1977

**PREVIOUS POSITIONS:**

LG&E Energy Corp., Louisville, KY  
December 1995 - May 1997, President, Distribution  
Services Division

December 1993 - May 1997, President, Louisville Gas and  
Electric Company

December 1992 - December 1993, Senior Vice President -  
Public Policy, and General Counsel

March 1992 - November 1992, Senior Vice President,  
General Counsel and Corporate Secretary

Long Island Lighting Company, Hicksville, NY

1989-1992 General Counsel and Secretary  
1988-1989 Deputy General Counsel  
1986-1988 Assistant General Counsel  
1985-1986 Managing Attorney  
1984-1985 Senior Attorney  
1980-1984 Attorney

**1995 Comprehensive Management Audit of  
Louisville Gas and Electric Company**

*Recommendation III-R-7*

III-R7     Investigate the use of Performance-Based Ratemaking as a means to improve the quality of service, reduce costs, and improve returns to stockholders. (Refer to Finding III-F21.)

LG&E should begin a detailed analysis of alternative ratemaking methods that can help it achieve some of the performance and earning objectives it seeks. As a first step, PBR systems that are in place in other regulatory jurisdictions should be reviewed to determine their applicability. Once this is complete, dialogue with the Kentucky PSC should be established to determine what alternatives are potentially acceptable. Finally, a decision should be made as to whether this approach should be considered.